> Most homes today have two lines in the drop. The cable behind the house has idle facilities. The additional investment for provisioning a second loop in most cases is close to zero. (Kansas Corporation Commission, p. 2).

> Sales of additional residential lines are of extreme relevance to any consideration of LEC embedded costs. Additional residential lines are in many, if not most, cases provisioned using already installed, existing plant and distribution equipment. So not only does the growth of additional lines provide ILECs with a substantial new revenue stream, additional lines are provisioned out of existing spare capacity and therefore make use of, and generate revenues from, plant that would otherwise be idle (and hence contributors to the "gap" or "stranded investment" problem) (Patricia Kravtin and Lee Selwyn, Assessing Incumbent LEC Claims to Special Revenue Recovery Mechanism:, January 29, 1997, p. 21, hereafter Special Revenue Claims).

It is particularly interesting to note in this regard that the profitability of second lines stems from the existence of excess capacity. Others note that the extreme profitability of vertical service results from the availability of excessive functionalities.

> Almost as significant [as second lines] to the RBHC's profitability has been the growth of revenues from vertical services. Vertical services are those offered by the BOC as complements to basic "plain old telephone services (POTS)... Significantly, the modern architecture of the voice telephone network allows the RBHCs to provide vertical services at relatively little cost. It is estimated that the RBHCs' margin on vertical services is approximately 60%, meaning that a large portion of those revenues goes directly to the ILEC's bottom line, or put another way, towards the recovery of the ILEC's embedded investment (Special Revenue Claims, p. 22).

Second lines and vertical services are revenue opportunities that are very likely to materialize, since they have been growing at a rapid rate. Similarly, the growth and productivity improvement estimates on which DPSNY relies are mere projections of historical trends. One would expect additional stimulation in a more vigorously competitive marketplace.

Finally, once the Baby Bells enter in-region long distance, they will be able quickly to gain market share and increase revenue. As noted in the Joint Commentors' initial filing, long distance is a very easy market for the ILECs to enter.

B. INEFFICIENCIES AND COMPETITIVE ADVANTAGES

Given these immense revenue opportunities, to be pursued largely from an already installed base of assets, it is not surprising to find that when the Baby Bells go abroad as competitors, they are particularly hard on claims that incumbents must be protected from the impact of competition. Overseas, these Baby Bells insist that interconnection charges be set to compel greater efficiency, and they also recognize the immense advantages of incumbency.

BellSouth Europe argues that incumbents will easily be able to accommodate competition because inefficiencies will be weeded out, and inherited advantages will give the incumbents a head start in the new competitive environment.

> The conventional wisdom that ex-monopolists are easily attacked by their new, market-hardened competitors has proven wrong for two fundamental reasons:
>
> Monopoly-bred inefficiency plays into the incumbents hands by (1) enabling dramatic improvements in operating results through relatively easy "fat-cutting" and (2) justifying high interconnection prices designed to largely recoup the incumbents' past inefficiencies...
>
> The incumbent brings enormous structural advantages to the competition in the form of a "paid-for" infrastructure, name recognition, brand loyalty, consumer inertia, preferential access to data regarding calling habits of its interconnecting competitor's customers, superior access to infrastructure, established regulatory/legislative relationships, etc. (BellSouth Europe, p. 7).
>
> Interconnection charges should reflect cost causation and, as such, should be based on long-run incremental costs.

> Interconnection charges should motivate incumbent efficiency.
>
> Rather than handicapping incumbents, past monopoly-bred inefficiencies often greatly advantage these incumbents when competition with new entrants requiring interconnection befits.
>
> Incumbents bring enormous structural advantages to competitive situations.
>
> To develop effective competition, interconnection charges must be adjusted to motivate incumbent efficiency and counterbalance the incumbent's considerable structural advantages (BellSouth Europe, p. 6).

Abroad, these Baby Bells have identified precisely the list of factors cited in Joint Commenters' initial comments. In addition to the previously noted revenue opportunities/strategic investments, these Baby Bells abroad also comment on excess profits and inefficiencies, all of which, according to their statements overseas, should be disallowed.

C. EXCESS PROFITS

BellSouth New Zealand points out that the current excess profits of incumbents have not been earned, but are the result of the legacy of monopoly.

> Telecomm is clearly earning monopoly profits. But those monopoly profits cannot be interpreted as a proper return for its ingenuity and initiative. Instead, those monopoly profits are the simple result of a monopoly franchise enjoyed by Telecomm by historical accident. Those monopoly profits do not produce the benefits that Schumpeter foresaw which would come from rewarding innovative entry into these markets (BellSouth New Zealand, p. 68).

The profit level that BellSouth New Zealand is complaining about in this text is a return on equity of 34.4% for Telecomm, compared to a return on equity of 17.2% for Business Week's Global 1000. (Business Week, July 8, 1996, Global 1000 Report). DPSNY also points out that regulation has allowed profits to become excessive.

> The past regulatory approach has allowed earnings to creep up to levels that would not reasonably be expected to be achieved in a rigorous competitive market.

> Elimination of past "benefits" now reflected in current access charge levels (e.g. a rollback of the unified tariff approach that allowed access charges to be set at a higher level than otherwise - worth about 1-2% by itself), and setting rates at an appropriate earnings level (worth 5-10% of rate levels), could result in an additional 6% to 12% rate reduction (DPSNY, p. 6).

We agree with these parties that the Baby Bells have been earning excess profits for years simply as a result of their position as a monopoly provider of local telephone service. In order for a competitive marketplace to develop, the Commission should immediately prescribe lower access charges that will help bring the Baby Bells' profit margins more in line with the competitive marketplace and, thereby, increase the opportunities for competition to develop and for consumers' rates to fall.

D. NON-RECOVERY OF INEFFICIENCIES

US West International is vigorous in its refusal to pay for inefficiencies of the incumbent.

> Local access loss and the universal service obligation should be funded independent of interconnection charges. In both cases, proportionate recovery should only be partially funded to promote incumbent efficiency (p. 14).
>
> US WEST has argued previously against the principle of "access deficit contributions"; we believe that the use of LRIC based on a "bottom-up" approach to identifying and quantifying cost drivers will demonstrate that, in practice, this supposed deficit is an artifice of arbitrary full-allocated costing methods. USW p. 8.
>
> US WEST has long argued against the use of fully allocated costs as the basis of setting interconnection charges and have instead called for the adoption of a regime based on forward-looking long run incremental costs (LRIC). We therefore strongly support OFTEL's conclusion that "for purposes of determining interconnection prices, the appropriate measure is long run average incremental cost."
>
> LRIC is a fair basis for interconnection because, when constructed through a "bottom up" approach, it is a secure form of calculating costs and ensures that operates are fully compensated for the costs they incur in interconnecting with other operators, including a fair return on any capital employed. At the same time,

> because LRIC is forward-looking, competitors are not paying for inefficiencies in an operator's network. USW, p. 12

DPSNY has estimated the potential for the write-off of inefficiencies as follows:

> One year's worth of interstate earnings (not an unprecedented level based on write-off experiences of other industries undergoing significant market changes would equal about 30% of one year's worth of access revenues or about 6% of revenues for the five-year projection period used in this analysis (i.e. 1996 through 2000). Write-offs taken by BOCs for SEC reporting purposes corroborate this figure. For example, NYNEX reduced its net plant by $3.5 billion via a one-time write-off to reflect the competitive environment. The interstate portion of this amount is in excess of 30% of one year's interstate carrier access revenues (DPSNY, p. 6).

Although DPSNY's underlying logic is fundamentally correct and its method of estimation reasonable, we believe that its actual estimate is too easy on the LECs. Joint Commentors' initial comments developed a method for estimating expected write-offs with direct reference to competitive companies. It showed that the figure DPSNY uses is too low by 50 percent.

E. THE GAP BETWEEN EFFICIENT PRICES AND EMBEDDED COSTS WILL BE MORE THAN FILLED BY COSTS WHICH SHOULD NOT BE RECOVERED AND BY NEW REVENUE OPPORTUNITIES.

Combining the DPSNY and Selwyn analyses of revenue opportunities and potential cost savings, as in Table 1, produces a huge pool of potential cost savings and revenue opportunities that would more than offset any access charge reductions.

TABLE 1

SOURCES OF COST SAVINGS AND REVENUE OPPORTUNITY
AVAILABLE TO LECS TO OFFSET ACCESS CHARGE REDUCTIONS
(BILLIONS OF DOLLARS PER YEAR -- YEAR 2000 ESTIMATE)

DEPARTMENT OF PUBLIC SERVICE OF NEW YORK	
LONG DISTANCE SERVICE	
GROWTH	2.1
PRODUCTIVITY	1.8
COMPETITIVE EFFECT	1.0- 2.0
MERGER BENEFIT	1.0
RESALE COST SAVING	.8
	7.3
SELWYN	
EXCESSIVE INVESTMENT	
OUTSIDE PLANT	5.1
SWITCHING	4.2
REVENUE OPPORTUNITIES	
SECOND LINE	2.0 - 3.0
VERTICAL SERVICES	4.0 - 7.0
LONG DISTANCE SALES	11.0 - 18.0
ADVANCED SERVICES	.4 -.5
YELLOW PAGES	2.0 - 2.5
TOTAL	35.4 - 48.0

F. FAIR COMPENSATION OF RISK

As noted in the initial comments of the Joint Commentors, it is unlikely that there are any stranded costs that would have to be recovered. However, even if such costs could be identified, a number of commentors noted that the ILECs have already been compensated or have been rewarded for the risks that they face.

> Under the price cap regime, LECs have been afforded earnings flexibility in exchange for certain price constraints. We believe that the FCC should work on the following presumptions: 1) LECs should not expect to be able to recover all or a substantial part of their embedded costs; 2) some LECs have already written off substantial amounts; 3) LECs accept a certain level of risk under a price cap regime. The Commission should take the view that the responsibility rests squarely on the LEC to show an untenable burden if embedded costs are not recovered through an extraordinary recovery mechanism. (Florida PSC, p. 10).
>
> State advocates strongly urge the FCC to reject any LEC claim to recover historical or embedded costs as a matter of constitutional right or as a matter of equity. Utilities are not entitled to recover costs that have become uneconomic due to competitive pressures. (State Advocates, p. 55).

V. CONCLUSION

In conclusion, the Joint Commentors believe that the Commission has the opportunity in this proceeding to bring immediate benefits to the small consumer. By taking the inefficiencies out of access charges, the Commission can lower the SLC and mandate the pass through of any reductions in access charges that the IXCs pay to the incumbent LECs without making the RBOCs whole. We believe that the RBOCs have been earning excess profits, have inefficiently built out their networks, have built-in advantages in a competitive marketplace, and will have tremendous new revenue opportunities under the Telecommunications Act of 1996.

Most importantly, some of the Baby Bells have recognized these arguments overseas. In attempting to get into the incumbent's market overseas, these Baby Bells have repeatedly argued that access and interconnection should be priced based on forward-looking, efficient costs. We believe that this argument is sound economically and would allow the Commission to give consumers immediate benefits in the form of lower prices and greater competition.

Wherefore, Commentors ask the Commission to accept the access charge reform proposals contained herein.

Respectfully Submitted,

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